



Profitably Expanding Distribution for LCC's

Introduction

In 1970, the typical airline was content to sell its seats at a government regulated profit. Passengers paid for the glamour and sizzle of flying, often dressing up as they would for a night on the town just to take a trip on silver wings. Airlines sold seats. They didn't sell beverages, luggage space, pillows or blankets. They sold a seat on a flight from one city to another. Routes were protected and business was generally quite good.

Sales channels were well defined. Bookings came from a travel agent or the airline's call center. Aside from a few consolidators and charters, there were no other options.

Fast forward to 2010: With the advent of Low Cost Carriers (LCCs), a passenger segment has become a commodity. So much so, that some airlines in India and elsewhere literally give seats away to stimulate traffic and market share. The Internet enabled a new breed of savvy consumer who could quickly and easily compare fares between carriers and shop for the lowest price. The days of travel agents booking the highest fares to increase their own commissions are long over. The airline that offers a ticket for \$1 or €1 cheaper than the next carrier will get the sale.

Expanding distribution is therefore critical to maximizing revenues. There are two main ways to do this, 1) incorporate new distribution channels and 2) sell additional items beyond the seat through those channels. In addition, the packaging of ancillary services (hotels, cars, excursions, events, etc.) along with fares creates a new product mix that masks individual price points and creates higher margins.

A Brief Airline History – From Computer Reservations Systems to Passenger Services Systems:

The early Computer Reservations Systems (CRS) were the precursor to today's more comprehensive Passenger Services Systems (PSS). Currently, what we at Radixx refer to as the Radixx Air® PSS, has been developed incrementally over the last 15 years and provides solutions for the three generally recognized types of carriers in the modern airline industry - Traditional, LCC and Hybrid. The core elements of these airline business models are dramatically different, therefore, requiring different enabling technology and processes.

Traditional (or legacy) systems are, at their core, inventory management systems. Most are based on IBM's Transaction Processing Facility (TPF). When they were originally designed, one mainframe could not talk to another. Even two IBM mainframes could not communicate directly. There was no Internet. All accounting and other functions were done on a batch basis. Batch files were used to load schedules, fares and other information. Making reservations was done through terminals using command line instructions on a green screen, because the mainframes had neither the power nor the operating systems necessary to enable graphical user interfaces. Payment and ticketing were both done outside the computer system. The systems were ultimately extended to communicate via text messages to GDSs and later via EDIFACT. Everything was designed to automate the former travel agency manual reservations flow. Credit cards were unknown. These systems were optimized for traditional travel agency distribution. More recently, middleware has been added and paper tickets have been replaced with virtual paper tickets. The systems price itineraries rather than individual segments, making the allocation of revenue between segments on multi-leg trips oftentimes challenging. There is no internal accounting function. Rather, data is extracted to offline revenue accounting systems. Furthermore, all data is purged from the online system soon after the last flight segment is flown on an itinerary. All customer relationship management (CRM) is typically relegated to external loyalty and CRM systems, since no customer specific data is maintained in the core system after the last leg of an itinerary has been flown.

In the 1980's and 90's, the first LCC systems were introduced. The systems were designed to support direct booking and they were built from the ground up to sell directly. Unlike traditional systems, they do not price itineraries, they price individual segments. Payment is handled directly. The systems are optimized for sale over the Internet. They are not generally as effective in selling through the GDSs, interlines or codeshares, but do an extremely good job of selling direct to consumers. Data is kept within the system for years after a flight is flown, but the underlying system is much more than an inventory management system, it is often a single entry accounting system designed to sell and take payments, as well as sell ancillary services.

The newest systems, often referred to as Hybrid systems, are designed to support all business models. Any mix of distribution channels can be used by the carrier. Distribution through traditional channels conforms to IATA standards and includes IATA standard eTicketing. Direct distribution is either ticketless or eTicketed. The underlying sales engine is similar to SAP or other ERP style systems which view the airline as a sales company that sells anything through any channel with any type of payment. Hence, ancillary services are inventory controlled, and have similar parameters as flight segments. A flight segment is viewed as a specialized form of ancillary service. The underlying engine is a double entry bookkeeping engine. The system prices both individual segments and itineraries. Revenue is accurately and immediately tracked and properly allocated to its source and date of recognition.

Expanding Distribution Channels: The Case of Great Lakes Aviation and Atlantic Coast Airlines

Many LCCs have a unique problem. With only one major booking channel (their own Web site and call center), generating sales is dependent upon driving consumers to that Web site or dialing that phone number. This may sound easy in theory. LCC model airlines need to spend enough advertising and direct marketing dollars to create a "brand" and drive a steady stream of consumers to the Web site by offering low price fares. These carriers seek to provide a successful customer experience in the hopes of developing an ongoing relationship. Southwest Airlines is perhaps the best example of this model.

The cost and complexity of creating such a brand driven business is high and some have found out the hard way that this strategy is not always easy. By limiting distribution and relying on brand driven sales solely via the Internet, many have discovered that it takes too long and too much money to build loads high enough to achieve break even. Some have therefore embraced a Hybrid model, finding it to be a much more effective strategy to pursue. Opening more sales channels, even if those channels have a higher unit cost, can net dramatically greater sales and resulting revenues.

To understand how distribution strategy can affect profitability, consider two very similar carriers faced with the identical problem in 2001.

Atlantic Coast Airlines and Great Lakes Aviation were both captive carriers of United Airlines; independent operators flying regional service as United Express in different regions of the U.S. under the livery of United. Both saw the handwriting on the wall as United cut back routes and sales declined. Their revenues and profits sank, as well. Various factors drove them both to distribute their own seats utilizing their own respective brands.

Atlantic decided to embrace the LCC model. Raising several hundred million USD they acquired a fleet of regional jets, painted them in their own colors, and began flying as Independence Air. They selected an LCC reservation system, advertised heavily, and turned on their new Internet booking engine. It took a little over a year before they went bankrupt. While there are many cost driven and competitive factors that led to their demise (including perhaps the high cost and limited functionality of their selected reservation system), they had a major problem on the revenue side: they simply could not generate enough demand via their own Web site to drive profitable loads. Failing the ability to access other distribution channels, they also failed in successfully building the new carrier.

Meanwhile, Great Lakes chose the Hybrid approach. Beginning in 2001 they strategically approached the issue of distribution by taking an incremental expansion strategy. The airlines' leadership realized that if they were to successfully make a transition they would need to convert from a captive carrier of United to flying those same routes "at risk" under their own livery. They would also need to find a PSS partner with the technology and know-how to help them access and leverage the best elements of past, present and future distribution channels.

Essentially, they chose to relinquish their United Express designation and become the operating codeshare partner to United Airlines as Great Lakes Aviation. Their old regional feeder routes flown as United Express out of Denver were now flown as Great Lakes, but United was still selling the same number of seats, this time as a United codeshare. Great Lakes then added a second codeshare with Frontier Airlines, which also had its hub at Denver, further expanding distribution. Utilizing Radixx technology and proprietary processes, Great Lakes became the regional feeder for both carriers.

Expanding yet further, they added another channel, selling their seats directly via the GDSs using traditional ticketing under their own code of "ZK". They then opened a call center and unveiled a Web site with a ticketless Internet booking engine enabling two additional distribution channels. As they continued to expand, they added IATA standard Interline E-Ticketing agreements with Continental, US Airways and others. They then expanded the distribution channels further by adding a travel agency direct and corporate direct Web portal. Reaching agreements with the government to fly essential air service added another opportunity.

The result of Great Lakes' incremental strategic plan focused on enhanced distribution has been steady profitability and growth. They have been consistently profitable for the last seven years and continue to grow.

The financial starting points of the two airlines were dramatically different: Atlantic Coast began with massive IPO fueled funding of several hundred million dollars. To put that in perspective, most airlines have started up with a small fraction of that amount. Great Lakes, on the other hand did not enjoy such deep pockets. But, they did have a strategic vision that they were able to implement and Radixx is proud to be their technology partner.

It's about both vision **and** the system! So, the key to Great Lake's success and Atlantic's demise was not in the funding, it was in strategic vision and the system selected. Atlantic chose a system designed just for LCCs. Great Lakes chose the Radixx Air® system that offered the flexibility to enable enhanced distribution and the technological and industry know-how to make it happen.

Selected Benefits of the Hybrid Expanded Distribution Strategy:

Benefits of the strategy described above include:

- Multi-channel distribution is expanded, giving airlines more control over each channel, and enabling them to maximize the benefit of each channel.
- Inventory can be managed by channel, with greater precision and control.
- Airlines can make better management decisions, create more revenue and allow personnel to focus on improving customer service, since all data is stored, managed and analyzed in one place.
- The BSP can be bypassed for Internet and many travel agent/corporate bookings, reducing the revenue management functions.
- Most bookings will be direct pay, so airlines enjoy accurate revenue numbers in a timely fashion.
- Airlines, not travel agents, will have almost complete control of inventory and revenue.
- No shows and go shows drop significantly and the need to pay to protect passengers is also reduced or eliminated.
- Revenue management utilizes much better data to calculate and project.
- Passengers become customers of the airline, instead of customers of the travel agent.
- Current GDS channels may still be maintained so existing relationships with GSAs, OTAs and others are not adversely affected.
- GDS fees and distribution costs are reduced, so costs per boarded passengers who book via the GDSs drop substantially.
- Costs are reduced and savings occur at every point.
- Dramatically simplifies the process in all channels, so training time for all users, including passengers, is minimal.
- Little development is necessary, except functions associated with setting up code shares, so new market opportunities can be responded to rapidly.
- General Sales Agents (GSA) around the world can access the airline directly or via the GDSs using standard approaches with which they are familiar.

- Provision of one fully integrated solution using best practices, rather than a mix of independent systems.
- Customer Relationship Management (CRM) data is effectively captured and utilized to personalize the relationship with the customer.
- New markets can easily be added at any time.
- Contract fares can be sold via the Internet.

Conclusion

There is a pattern in the industry, in large part because of system limitations, to be slow in responding to new market opportunities. Clearly, rapid and cost-effective technological responsiveness, especially as it pertains to broadening distribution, is the key to fulfilling an airline's strategic vision and enabling it to attain consistent profitability. Airlines that have utilized the Radixx Air next generation technology and processes have been trail blazers in responding to market opportunities.